

Interim Financial Statements of

**PHOENIX COAL INC.**

For the three and six months ended June 30, 2008

*(Unaudited – Prepared by Management)*

**Management's Comments On Unaudited Financial Statements**

The accompanying unaudited interim financial statements of Phoenix Coal Inc. for the three and six months ended June 30, 2008 have been prepared by management and approved by the Board of Directors of the Company. These statements have not been reviewed by the Company's external auditors.

**PHOENIX COAL INC.**  
**CONSOLIDATED BALANCE SHEETS**

(Expressed in U.S. Dollars)

	Note	June 30 2008	December 31 2007
		(unaudited)	
<b>ASSETS</b>			
<b>Current Assets</b>			
Cash and cash equivalents.....		\$ 71,154,101	\$ 381,374
Investments .....		—	153,100
Trade accounts receivable .....		4,016,827	4,314,385
Accounts receivable — other .....		16,858	16,858
Coal inventories .....		260,137	1,072,697
Prepaid expenses and other current assets.....		323,176	526,664
<b>Total current assets</b> .....		75,771,099	6,465,078
<b>Property, Plant and Equipment</b> , net .....	F, I	33,904,888	29,028,582
<b>Restricted Cash</b> .....	I	2,226,075	2,312,500
<b>Mining Rights and Mine Development Costs</b> , net of accumulated amortization of \$1,508,349 at June 30, 2008 and \$210,658 at December 31, 2007.....	E	49,948,935	33,858,058
<b>Other Assets</b> .....		1,977,834	1,116,838
		<b>\$163,828,831</b>	<b>\$ 72,781,056</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>			
<b>Current Liabilities</b>			
Trade accounts payable and accrued liabilities .....		\$ 11,197,646	\$ 8,896,898
Vendor financing.....	E, G	—	7,794,000
Preferred stock, subject to redemption provisions .....	G	—	45,635,369
Notes payable.....	G	—	5,526,785
Current portion of long-term debt .....	G	3,796,359	2,338,198
<b>Total current liabilities</b> .....		14,994,005	70,191,250
<b>Reclamation Liability</b> .....		3,851,919	3,757,353
<b>Long-term Debt</b> , less current portion .....	G	10,556,177	7,348,915
<b>Other Long-term Liabilities</b> .....		677,144	707,796
<b>Stockholders' Equity</b>			
Share capital .....	D, G	171,805,143	22,426,771
Stock options and warrants .....	J	12,981,712	1,458,884
Accumulated deficit .....		(51,037,269)	(33,109,913)
		133,749,586	(9,224,258)
		<b>\$163,828,831</b>	<b>\$ 72,781,056</b>

*See accompanying notes to consolidated financial statements*

PHOENIX COAL INC.

CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

Three and Six Months Ended June 30, 2008 and 2007

(Expressed in U.S. Dollars)

	Note	Three Months Ended		Six Months Ended	
		June 2008	June 2007	June 2008	June 2007
Coal sales.....		\$ 21,326,102	\$ 16,494,604	\$ 39,821,562	\$ 32,589,816
<b>Cost and Expenses:</b>					
Cost of goods sold.....		21,199,549	15,241,838	38,684,869	28,325,576
Selling expenses.....		2,074,001	1,842,529	4,144,935	3,455,681
General and administrative expenses.....	J	3,813,178	1,581,672	5,412,290	2,736,724
Depreciation and amortization.....		2,043,344	712,721	3,107,176	1,283,565
		<u>29,130,072</u>	<u>19,378,760</u>	<u>51,349,270</u>	<u>35,801,546</u>
<b>Loss from operations.....</b>		<b>(7,803,970)</b>	<b>(2,884,156)</b>	<b>(11,527,708)</b>	<b>(3,211,730)</b>
<b>Other Income (Expense)</b>					
Interest expense, including accretion.....	G	(2,765,589)	(1,300,198)	(5,124,968)	(2,130,646)
Interest income.....		14,060	18,640	26,721	43,657
Foreign currency (loss) gain.....	G	(103,710)	—	129,130	—
Other, net.....		(37,302)	850,774	(215,152)	827,573
		<u>(2,892,541)</u>	<u>(430,784)</u>	<u>(5,184,269)</u>	<u>(1,259,416)</u>
<b>Loss before income taxes.....</b>		<b>(10,696,511)</b>	<b>(3,314,940)</b>	<b>(16,711,977)</b>	<b>(4,471,146)</b>
Income tax (benefit).....		(879)	660	(879)	660
<b>Net loss.....</b>		<b><u>\$(10,695,632)</u></b>	<b><u>\$(3,315,600)</u></b>	<b><u>\$(16,711,098)</u></b>	<b><u>\$(4,471,806)</u></b>
Basic net loss per share.....		\$ (.25)	\$ (.09)	\$ (.42)	\$ (.12)
Weighted average common shares outstanding.....		42,036,051	37,319,711	39,868,745	37,174,623

See accompanying notes to consolidated financial statements

PHOENIX COAL INC.

CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY (UNAUDITED)

Six months ended June 30, 2008 and 2007

(Expressed in U.S. Dollars)

	Note	Common Shares		Options and Warrants	Accumulated Deficit	Total
		Shares	Dollars			
<b>December 31, 2007</b> .....		37,701,440	\$ 22,426,771	\$ 1,458,884	\$(33,109,913)	\$ (9,224,258)
Common shares issued for loan fees.....	D, G	408,163	510,204	—	—	510,204
Conversion of finance company debt to common shares .....	D, G	8,668,000	10,276,682	—	—	10,276,682
Conversion of preferred shares, including accrued dividends, to common shares.....	D, G	39,386,270	48,922,722	—	—	48,922,722
Value of additional shares distributed on conversion of finance company debt .....	D, G	—	808,258	—	(808,258)	—
Share-based compensation - options.....	J	—	—	260,000	—	260,000
Balances – pre merger, pre offering, and prior to recording loss for the period .....		86,163,873	82,944,637	1,718,884	(33,918,171)	50,745,350
Marimba Capital Corp. equity balances pre-merger .....	D	2,320,000	347,514	48,120	(88,255)	307,379
Marimba Capital shares consolidated at 1 share to every 2.35 shares outstanding.....	D	(1,332,769)	—	—	—	—
Reverse takeover adjustment .....	D	—	(88,255)	—	88,255	—
Reverse takeover costs incurred.....	D	—	—	—	(408,000)	(408,000)
Net proceeds from common share offering..	D	62,857,160	97,784,678	—	—	97,784,678
Warrants issued with common share offering .....	D, J	—	(8,077,145)	8,077,145	—	—
Broker options issued .....	D, J	—	(1,106,286)	1,106,286	—	—
Share-based compensation - options.....	J	—	—	2,031,277	—	2,031,277
Net loss .....		—	—	—	(16,711,098)	(16,711,098)
<b>June 30, 2008</b> .....		<u>150,008,264</u>	<u>\$171,805,143</u>	<u>\$12,981,712</u>	<u>\$(51,037,269)</u>	<u>\$133,749,586</u>

	Common Shares		Options and Warrants	Accumulated Other Comprehensive Income	Accumulated Deficit	Total
	Shares	Dollars				
<b>December 31, 2006</b> .....	36,392,667	\$21,040,818	\$47,224	\$(143,858)	\$ (7,118,778)	\$13,825,406
Share capital contribution – common shares .....	831,440	1,039,300	—	—	—	1,039,300
Exercise of stock options .....	300,000	125,000	—	—	—	125,000
Net loss .....	—	—	—	—	(4,471,806)	(4,471,806)
<b>June 30, 2007</b> .....	<u>37,524,107</u>	<u>\$22,205,118</u>	<u>\$47,224</u>	<u>\$(143,858)</u>	<u>\$(11,590,584)</u>	<u>\$10,517,900</u>

See accompanying notes to consolidated financial statements

PHOENIX COAL INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

Three and Six Months Ended June 30, 2008 and 2007

(Expressed in U.S. Dollars)

	Three Months Ended			Six Months Ended	
	Note	June 2008	June 2007	June 2008	June 2007
<b>Cash Flow From Operating Activities</b>					
Net loss		\$(10,695,632)	\$(3,315,600)	\$(16,711,098)	\$(4,471,806)
Adjustments to reconcile net loss to net cash used in operating activities:					
Depreciation and amortization.....		3,296,291	1,011,288	5,424,704	1,610,404
Loss (gain) on sale of property and equipment.....		37,202	(856,672)	214,057	(833,465)
Interest rate swap.....	G	(120,501)	—	(15,160)	—
Foreign currency loss (gain).....	G	103,710	—	(129,130)	—
Share-based compensation.....	J	2,151,277	—	2,291,277	—
Reclamation liability accretion.....		47,283	—	94,566	—
Dividends accrued on preferred stock.....	G	703,344	—	1,467,165	—
Changes in operating assets and liabilities:					
Accounts receivable.....		209,615	682,601	297,558	(2,314,884)
Inventories.....		136,150	417,570	812,560	(179,660)
Prepaid expenses and other current assets.....		197,521	67,446	203,488	(241,793)
Trade accounts payable, accrued liabilities and other liabilities.....		(633,470)	1,085,266	2,315,908	5,254,163
<b>Net cash used in operating activities.....</b>		<b>(4,567,210)</b>	<b>(908,101)</b>	<b>(3,734,105)</b>	<b>(1,177,041)</b>
<b>Cash Flow From Investing Activities</b>					
Restricted cash.....	I	122,900	(18,537)	86,425	(37,056)
Reduction in investments.....		153,100	6,600	153,100	71,596
Payments for other assets and mine development.....		(166,910)	(427,809)	(1,043,559)	(601,867)
Proceeds from sale of property and equipment.....		30,000	1,347,642	403,300	1,938,949
Payments for property and equipment.....	F	(179,366)	(562,835)	(214,512)	(1,187,306)
Net assets acquired in merger, prior to public offering.....	D	307,379	—	307,379	—
Acquisitions.....	E	(25,000,000)	(206,194)	(25,000,000)	(11,816,109)
<b>Net cash used in investing activities.....</b>		<b>(24,732,897)</b>	<b>138,867</b>	<b>(25,307,867)</b>	<b>(11,631,793)</b>
<b>Cash Flow From Financing Activities</b>					
Principal payments on long-term debt.....	G	(202,407)	(1,082,502)	(400,984)	(2,306,667)
Proceeds from debt.....	G	4,891,890	—	4,891,890	4,660,042
Payments on equipment financing.....	G	(1,236,536)	—	(2,022,231)	—
Line of credit.....	G	(3,050,000)	1,950,000	—	2,175,000
Reverse takeover costs incurred.....	D	(408,000)	—	(408,000)	—
Financing fees.....		—	(79,544)	—	(189,014)
Decrease in other long term liabilities.....		(25,364)	(143,720)	(30,654)	(196,124)
Net proceeds from capital contributions.....	D	97,784,678	125,000	97,784,678	358,500
<b>Net cash provided by financing activities.....</b>		<b>97,754,261</b>	<b>769,234</b>	<b>99,814,699</b>	<b>4,501,737</b>
<b>Net Increase (Decrease) in Cash and Cash Equivalents.....</b>		<b>68,454,154</b>	<b>—</b>	<b>70,772,727</b>	<b>(8,307,097)</b>
<b>Cash and Cash Equivalents, Beginning of Period.....</b>		<b>2,699,947</b>	<b>—</b>	<b>381,374</b>	<b>8,307,097</b>
<b>Cash and Cash Equivalents, End of Period.....</b>		<b>\$ 71,154,101</b>	<b>\$ —</b>	<b>\$ 71,154,101</b>	<b>\$ —</b>
<b>Supplemental Disclosure:</b>					
Interest paid.....		\$ 803,398	\$ 882,701	\$ 1,218,152	\$ 1,742,010
<b>Non-Cash Investing and Financing Activities:</b>					
Vendor financing of acquisition.....		\$ —	\$ —	\$ —	\$ 9,391,170
Vendor financing for equipment purchases.....		\$ 4,797,889	\$ —	\$ 7,088,637	\$ —
Stock issued in connection with acquisition.....		\$ —	\$ —	\$ —	\$ 543,300

See accompanying notes to consolidated financial statements

## PHOENIX COAL INC.

### NOTES TO INTERIM FINANCIAL STATEMENTS (UNAUDITED)

Three and Six Months Ended June 30, 2008 and 2007

#### NOTE A — NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

*Nature of Operations:* Phoenix Coal Inc. (the “Company”) was created on June 27, 2008 by the reverse takeover (“RTO”) by Phoenix Coal Corporation (“Phoenix”) of Marimba Capital Corp. (“MCC”), which was previously listed on the TSX Venture Exchange (Note D). MCC was incorporated under the Business Corporations Act (Alberta) on February 8, 2007 and was classified as a Capital Pool Company as defined in the TSX Venture Exchange Policy 2.4 and, accordingly, had no assets other than cash and no commercial operations. MCC changed its name to Phoenix Coal Inc. on June 25, 2008. Phoenix, a U.S. company headquartered in Madisonville, Kentucky with satellite offices in Champaign, Illinois and Louisville, Kentucky, was formed in July 2004 as a Delaware C corporation and was originally named Dynamic Separations, Inc. (“DSI”). The Company is engaged in the production and sale of steam coal to utilities and industrial fuel consumers.

*Principles of Consolidation:* The Company’s consolidated financial statements include Phoenix Coal Inc. and its subsidiaries, all of which are wholly owned: Phoenix Coal Corporation, Schoate Mining Company, LLC; R & L Winn, Inc; Crittenden County Coal, Inc; Evergreen Mineral Company, Inc; Old Liberty Equipment Company, Inc; Maroon Reclamation LLC; Phoenix Coal Processing Company, LLC; Dynamic Separations, LLC; Charolais Mining Company, LLC; Charolais Coal Sales, LLC and Pact Resources, LLC.

*Basis of Presentation:* The accompanying interim unaudited consolidated financial statements of the Company have been prepared in accordance with Canadian generally accepted accounting principles (“GAAP”) for interim financial statements and accordingly do not include all disclosures required for annual financial statements. All monetary references expressed in these notes are references to United States dollars, except occasional references to Canadian dollars amounts, where the dollar amount is preceded by Cdn (“Cdn\$”).

With the exception of new accounting pronouncements discussed in this note A, these interim consolidated financial statements follow the same significant accounting policies and methods of application as the Company’s and Phoenix’s audited annual consolidated financial statements for the year ended December 31, 2007 (the “**Annual Financial Statements**”). The interim consolidated financial statements should be read in conjunction with the Annual Financial Statements.

In the opinion of management, all adjustments (including normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for these interim periods are not necessarily indicative of the results that may be expected for the full fiscal year ending December 31, 2008

MCC’s fiscal year previously ended on March 31. The Company recently changed its fiscal year-end to December 31 to coincide with Phoenix’s fiscal year-end.

*Reverse takeover accounting:* The RTO was completed on June 27, 2008. Prior to the completion of the RTO, MCC affected a reverse split of its outstanding common shares on the basis of 1 new share for each 2.35 shares outstanding. Pursuant to the RTO, the Company issued one common share for each outstanding common share of Phoenix. In addition, warrants and options to purchase Phoenix common shares outstanding immediately prior to the RTO were replaced with warrants and options to purchase an equivalent number of common shares of the Company, on economically equivalent terms and conditions. The capital changes of the Company are detailed in note D to these interim consolidated financial statements.

Concurrently, the Company raised \$97,784,678, net of issuance costs, in a prospectus offering of 62,857,160 subscription receipts priced at Cdn\$1.75. In connection with the RTO, each subscription receipt was exchanged for one unit, each unit consisting of one common share and one half common share purchase warrant exercisable for 24 months at Cdn\$2.25 per share.

The acquisition of the shares of Phoenix has been accounted for as an RTO transaction in accordance with guidance provided in Emerging Issues Committee (“EIC”) Abstract No. 10. As MCC did not qualify as a business for accounting purposes, the transaction has been accounted for as a capital transaction of Phoenix. Pursuant to the RTO transaction, these consolidated financial statements for the period ended June 30, 2008 reflect the assets, liabilities and results of operations of Phoenix prior to the RTO and the consolidated assets, liabilities and results of operations of the Company and Phoenix subsequent to the RTO. The consolidated financial statements are issued under the name of the legal parent (the Company), but are deemed to

## PHOENIX COAL INC.

### NOTES TO INTERIM FINANCIAL STATEMENTS (UNAUDITED) (Continued)

#### Three and Six Months Ended June 30, 2008 and 2007

be a continuation of the legal subsidiary (Phoenix). Net loss per share has also been adjusted for the RTO transaction for all periods presented in accordance with the guidance provided in EIC Abstract No. 10.

The net assets acquired are as follows:

Cash, including net cash raised in the prospectus offering of \$100,269,547 .....	\$100,453,942
Other assets .....	6,849
Less: Current liabilities .....	<u>(653,024)</u>
Net assets acquired .....	<u>\$ 99,807,767</u>

*Capital Disclosures and Financial Instruments – Disclosures and Presentation:* On December 1, 2006, the CICA issued three new accounting standards: Capital Disclosures (Handbook Section 1535), Financial Instruments – Disclosures (Handbook Section 3862), and Financial Instruments – Presentation (Handbook Section 3863). These new standards became effective for the Company on January 1, 2008.

*Capital Disclosures:* Handbook Section 1535 specifies the disclosure of (i) an entity’s objectives, policies and processes for managing capital; (ii) quantitative data about what the entity regards as capital; (iii) whether the entity has complied with any capital requirements; and (iv) if it has not complied, the consequences of such noncompliance. The Company has included disclosures recommended by the new Handbook section in note C to these interim consolidated financial statements.

*Financial Instruments:* Handbook Sections 3862 and 3863 replace Handbook Section 3861, Financial Instruments – Disclosure and Presentation, revising and enhancing its disclosure requirements, and carrying forward unchanged its presentation requirements. These new sections place increased emphasis on disclosures about the nature and extent of risks arising from financial instruments and how the entity manages those risks. The Company has included disclosures recommended by the new Handbook section in note H to these interim consolidated financial statements.

*Inventories:* Effective January 1, 2008, the Company adopted new accounting recommendations from the CICA, Handbook Section 3031, “Inventories”, which supersedes the previously issued standard on inventory. The new standard introduces significant changes to the measurement and disclosure of inventory. The measurement changes include: the elimination of LIFO, the requirement to measure inventories at the lower of cost and net realizable value method, for inventories that are not ordinarily interchangeable and goods or services produced for specific purposes, the requirement for an entity to use a consistent cost formula for inventory of a similar nature and use, and the reversal of previous write-downs to net realizable value when there is a subsequent increase in the value of inventories. Disclosures of inventories have also been enhanced. Inventory policies, carrying amounts, amounts recognized as an expense, write-downs and the reversals of write-downs are required to be disclosed. This standard has had no material impact on the Company’s consolidated financial statements.

#### NOTE B — FUTURE ACCOUNTING CHANGES

##### Goodwill and Intangible Assets

The CICA has issued a new standard which may affect the financial disclosures and results of operations of the Company for interim and annual periods beginning January 1, 2009. Section 3064, Goodwill and intangible assets, establishes revised standards for recognition, measurement, presentation and disclosure of goodwill and intangible assets. Concurrent with the introduction of this standard, the CICA withdrew EIC-27, Revenues and Expenses during the pre-operating period. The Company is currently assessing the impact of this new accounting standard on its consolidated financial statements.

##### International Financial Reporting Standards (“IFRS”)

In 2006, the Canadian Accounting Standards Board (“AcSB”) published a new strategic plan that will significantly affect financial reporting requirements for Canadian companies. The AcSB strategic plan outlines the convergence of Canadian GAAP with IFRS over an expected five year transitional period. In February 2008, the AcSB announced that 2011 will be the changeover date for publicly listed companies to use IFRS, which will replace Canadian GAAP. The transition date is for

## PHOENIX COAL INC.

### NOTES TO INTERIM FINANCIAL STATEMENTS (UNAUDITED) (Continued)

#### Three and Six Months Ended June 30, 2008 and 2007

interim and annual financial statements for fiscal years beginning on or after January 1, 2011. This transition date will require the restatement for comparative purposes of amounts reported by the Company for the fiscal year ending December 31, 2010. The Company is currently assessing the impact of IFRS on its financial statements.

#### NOTE C – CAPITAL MANAGEMENT

The Company manages its capital structure and makes adjustments to it, based on the funds available to the Company, in order to support the acquisition, exploration and development of mineral properties. The Board of Directors does not establish quantitative return on capital criteria for management, but rather relies on the expertise of the Company's management to sustain future development of the business. The Company defines capital to include its working capital position and the capital stock, warrant, and option components of its shareholders equity.

The Company manages its capital structure in a manner that provides sufficient funding for mine development and operational activities. Funds are primarily secured through a combination of equity capital raised by way of issuing equity instruments and external debt. In order to maintain or adjust the capital structure, the Company may attempt to raise additional financing through the issuance of new equity instruments, the exercise of outstanding common share warrants and stock options. Management reviews its capital management approach on an ongoing basis and believes that this approach, given the relative size of the Company, is reasonable.

There were no changes in the Company's approach to capital management during the three and six months ended June 30, 2008. Neither the Company nor its subsidiaries are subject to externally imposed capital requirements.

#### NOTE D — RTO AND CAPITAL

On May 22, 2008, MCC and Phoenix entered into a definitive merger agreement with respect to the RTO discussed in note A. On May 22, 2008, MCC also filed a preliminary prospectus for an offering (the "Offering") of Subscription Receipts (the "**Subscription Receipts**"), each Subscription Receipt to entitle the holder thereof to receive one unit (a "**Unit**"), each Unit consisting of one Common Share of MCC and one-half of one warrant of MCC, subject to the satisfaction of certain conditions. MCC applied to have the common shares and warrants listed on the Toronto Stock Exchange (the "**TSX**"). The Subscription Receipts were offered to the public in all of the provinces of Canada, except for Quebec, and in the United States in an offering exempt from the registration and prospectus requirements of the U.S. Securities Act. Subject to applicable law, the agents acting in connection with the Offering also offered the Subscription Receipts outside of Canada and the United States. The Offering consisted of up to 62,857,160 Subscription Receipts at a price of Cdn\$1.75 per Subscription Receipt to raise gross proceeds of Cdn\$110,000,030. In addition, the agents were granted an over-allotment option to acquire up to an additional 15% of common shares of MCC and/or warrants of MCC at prices of Cdn\$1.62 and Cdn\$0.26, respectively (for an implied aggregate price per Unit of Cdn\$1.75). Based on the Offering, this resulted in an over-allotment option of 9,428,572 common shares and 4,714,286 warrants. The over-allotment option was not exercised and expired on July 27, 2008.

Pursuant to an agreement among MCC, the Company and the Offering agents, the agents received a cash commission equal to 6% of the gross proceeds of the Offering plus compensation options equal to 4% of the Subscription Receipts sold pursuant to the Offering.

A summary of the gross proceeds received and Offering costs incurred is as follows:

Gross proceeds (Cdn\$110,000,030 converted to U.S. dollars at a conversion rate of 0.99007 U.S. to Cdn) .....	\$108,908,500
Agents' fees .....	(6,534,510)
Other out-of-pocket expenses .....	(4,589,312)
Net proceeds .....	<u>\$ 97,784,678</u>

In addition to the Offering costs, the Company incurred an estimated \$408,000 in costs related to the RTO which have been treated as a capital transaction and charged to accumulated deficit.

**PHOENIX COAL INC.**

**NOTES TO INTERIM FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

**Three and Six Months Ended June 30, 2008 and 2007**

Capital stock activity, including that which was related to the RTO, is detailed as follows:

<b>Phoenix Common Shares Issued – 105,000,000 authorized, \$.001 stated value per share</b>	<b>Number of Shares</b>	<b>Amount</b>
Balance, December 31, 2007	37,701,440	\$22,426,771
Conversion of finance company debt to common shares, including EIC – 96 adjustment – note G.....	8,668,000	11,084,940
Issued for fees on Quest debt – note G .....	408,163	510,204
Conversion of preferred shares to common shares – note G .....	37,190,267	46,177,718
Issued to settle dividends on preferred shares – note G.....	2,196,003	2,745,004
Balance on June 27, 2008, pre RTO	<u>86,163,873</u>	<u>\$82,944,637</u>

<b>Phoenix Preferred Shares Issued - 40,000,000 authorized, \$.001 stated value per share</b>	<b>Number of Shares</b>	<b>Amount</b>
Balance, December 31, 2007, excluding accrued dividends of \$1,277,839	37,190,267	\$ 44,357,530
Accretion of preferred offering costs.....		1,820,188
Conversion of preferred shares to common shares – note G.....	(37,190,267)	(46,177,718)
Balance, June 27, 2008	<u>—</u>	<u>\$—</u>

<b>MCC and Company Common Shares Issued – unlimited authorized</b>	<b>Number of Shares</b>	<b>Amount</b>
Balance, December 31, 2007	2,320,000	\$ 347,514
Consolidated at 1:2.35 – note A.....	(1,332,769)	—
Balance after consolidation.....	987,231	347,514
Issued in public offering.....	62,857,160	97,784,678
Balance, June 27, 2008, before reverse takeover.....	63,844,391	98,132,192
Reverse takeover adjustment.....	—	(88,255)
Value of broker options and shareholder warrants issued with public offering.....	—	(9,183,431)
Share capital arising from RTO transaction on June 27, 2008.....	86,163,873	82,944,637
Balance June 30, 2008	<u>150,008,264</u>	<u>\$171,805,143</u>

**NOTE E — PACT ACQUISITION**

In October 2007, the Company acquired the membership interests in Pact Resources LLC (“PACT”) upon exercising its option in September 2007 pursuant to the option agreements dated September 7, 2006 (the “Option Agreements”). Through the acquisition of PACT, the Company controls the leases for the proposed Pratt Mine within the area of interest as defined in the Option Agreements. The proposed Pratt Mine contains both underground and surface coal totaling 33,833,000 tons of measured and indicated resources, 670,000 tons of inferred resources and 28,933,000 tons of proven and probable reserves. The Company has been carrying out development work on the proposed Pratt Mine since the fourth quarter of 2006 and is in the process of permitting the reserve.

In addition to the leases for the proposed Pratt Mine, the sellers of PACT delivered to the Company the lease for the Panama South property and, as a result, the in-place tons associated with the Panama South property are included in the calculation of the Scheduled Payment (as described below). The Panama South property contains both underground and surface coal totaling 76,287,000 tons of measured and indicated resources.

Per the Option Agreements, in addition to the scheduled payment for in-place tons of coal delivered by the sellers (the “Scheduled Payment”), which payment terms would be subsequently modified, the Company agreed to pay \$300,000 (the “Option Fee”) at the effective date of the Option Agreements, an overriding royalty no greater than 3% of the gross sales price per ton sold from the proposed Pratt Mine (the “Overriding Royalty”) and expenses related to the development of the proposed Pratt Mine during the option period (the “Pratt Expenses”). Prior to the closing of the acquisition, the Company and the sellers of PACT modified the original Option Agreements and entered into modification of option agreements (the “Modification of Option Agreements”). The Modification of Option Agreements stipulated that the Scheduled Payment was \$15,000,000 payable in three installments, \$10,000,000 of which was paid in 2007, plus a true-up payment of \$0.10 per in-place ton on September 7, 2008 for any additional tons of coal greater than 150,000,000 in-place tons that the sellers deliver. As of December 31, 2007, the Company estimated that the sellers had already delivered

**PHOENIX COAL INC.**

**NOTES TO INTERIM FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

**Three and Six Months Ended June 30, 2008 and 2007**

177,940,000 in-place tons of coal for a total Scheduled Payment of \$17,794,000. As such, the Company recorded an additional \$7,794,000 of Vendor Financing on the balance sheet due the former owners of PACT. Of this amount, \$5,000,000 was originally payable in April 2008, with the balance due in September 2008.

On March 31, 2008, the Company entered into a buy-out agreement with the former owners of Pact Resources, LLC (“PACT”) (the “**Buy-out Agreement**”). Pursuant to a public offering of the Company’s shares or a private sale of more than 50% of the Company’s issued and outstanding stock or more than 50% of its assets (the “**Monetization Event**”), the Company would pay the former owners of PACT \$25 million within thirty days after the Monetization Event (the Buy-out Payment”). Per the Buy-out Agreement, Phoenix’s obligations to make a \$5 million payment in April 2008 and the balance in September 2008 were suspended until the occurrence of a Monetization Event. Upon receipt of the Buy-out Payment, all obligations of Phoenix to make any additional payments, including the accrued amount on the balance sheet as of December 31, 2007 and future overriding royalty payments, would cease and terminate.

In June, 2008, the Company and the former owners of PACT entered into an agreement to clarify and amend certain terms of the Buy-out Agreement. The parties acknowledged and agreed that a reverse takeover would qualify as and constitute a Monetization Event under the Buy-out Agreement. In the event the Monetization Event was a reverse takeover, the Buy-out Payment would be paid by the Company to the former owners of PACT within three days of MCC’s receipt of the proceeds from the public offering. If the offering is not closed on or before July 1, 2008, then all obligations of the Company to make additional payments to the former owners of PACT for the PACT properties would be reinstated at that time. On June 27, the Company completed the RTO and subsequently paid \$25,000,000 to the former owners of Pact on June 30, 2008. At December 31, 2007, Phoenix’s acquisition costs in PACT totaled \$18,909,000. With the \$25,000,000 Buy-out Payment paid on June 30, less the vendor financing of \$7,794,000 previously recorded at December 31, 2007, the acquisition costs increased by \$17,206,000 during the three months ended June 30, 2008, with a corresponding increase in mining rights.

As of June 30, 2008, the Company’s total acquisition cost of PACT was comprised of the Option Fee, Pratt Expenses, the Scheduled Payments, and the Buy-out Payment which totaled \$36,115,000 (the “**Purchase Price**”).

Option Fee .....	\$ 300,000
Pratt Expenses.....	815,000
Scheduled Payments and Buy-out Payment.....	<u>35,000,000</u>
	<u>\$36,115,000</u>

The Purchase Price was allocated to the following identifiable assets::

Cash .....	\$ 3,000
Advance royalties .....	42,000
Land purchase option.....	75,000
Mine development .....	713,000
Mining rights .....	<u>35,282,000</u>
	<u>\$36,115,000</u>

At the acquisition date, the owners of PACT owned less than 1% of the total outstanding shares of the Company and also held 300,000 options to purchase common shares of the Company. The PACT purchase price was negotiated by members of senior management that had no financial ownership in PACT and was considered to be an arms-length transaction.

During the current period, the Company finalized the purchase allocation and related valuation of the assets acquired and liabilities assumed for the PACT acquisition. Initially, the purchase price in excess of tangible and identifiable assets was allocated to goodwill. However, as PACT is a development stage enterprise which has not yet commenced commercial production, the Company has concluded that the allocation should be to acquired mining rights. In addition, for the Company’s previous acquisitions, the amount of the purchase price in excess of the value of tangible net assets was also allocated to goodwill. The Company has also concluded that it should reclassify value from goodwill to mining rights for these acquisitions as well. Consequently, on the June 30, 2008 balance sheet, the Company has reclassified \$32,393,227 previously shown as goodwill at December 31, 2007 to Mining Rights and Mine Development Costs. Other than this

**PHOENIX COAL INC.**

**NOTES TO INTERIM FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

**Three and Six Months Ended June 30, 2008 and 2007**

reclassification, the change in the purchase allocation for the PACT and prior acquisitions has had no material impact on the reported financial position or results of operations of any prior periods.

**NOTE F — PROPERTY AND EQUIPMENT, NET**

Property and equipment consists of the following:

	<b>June 30, 2008</b>	<b>December 31, 2007</b>
	(unaudited)	
Land.....	\$ 599,654	\$ 599,654
Building and improvements.....	25,424	25,424
Preparation plant.....	1,530,561	1,476,806
Mining equipment.....	34,205,335	27,684,862
Loading and marine transport equipment .....	1,775,000	1,775,000
Office equipment .....	325,754	324,684
Vehicles .....	65,965	65,965
	38,527,693	31,952,395
Less accumulated depreciation and amortization .....	(4,622,805)	(2,923,813)
	\$33,904,888	\$29,028,582

In the first six months of 2008, the Company continued its capital expenditure program to strategically replace certain pieces of its equipment fleet in order to reduce maintenance costs, increase equipment availability, and expand production capacity. During the period it purchased approximately \$7,100,000 of mining equipment as part of this strategy.

**NOTE G — DEBT**

The Company has a \$3.1 million secured line-of-credit agreement with a bank for working capital purposes. The line-of-credit is collateralized by all general business assets of the Company (except for the assets held by PACT and certain reserves held by Evergreen Mineral Company, Inc.), including but not limited to all equipment now owned and hereafter acquired, accounts receivables and inventory. The line bears interest at the LIBOR rate plus 4% (7.46% at June 30, 2008). There was no outstanding balance on the line-of-credit at June 30, 2008 and December 31, 2007. On July 7, 2008, the Company terminated the line of credit and the collateral will be released.

In 2007, the Company conducted a preferred stock offering. Preferred stock was issued in August 2007 and the proceeds used for working capital and the reduction of outstanding debt. The holders of preferred stock had the right to that number of votes equal to the number of shares of common stock issuable upon conversion of the preferred stock. Subject to the restrictions of any credit facility that may have been in effect, the preferred stock paid a 6.5% per annum cumulative dividend upon redemption or in common shares upon conversion.

Preferred stock could have been converted by the holder at any time to common stock based on a conversion formula incorporating the issue price of the preferred stock and subsequent values of common stock. The preferred stock would be converted automatically into common stock upon the closing of an underwritten public offering of shares of the common stock of the Company or if the holders of a majority of the preferred stock consented to the conversion into common stock. Additionally, subject to various restrictions and the automatic and voluntary conversion provisions noted, commencing one year after issuance of the preferred stock, the holder could request redemption of the preferred stock at its issue price (\$1.25 per share) plus any unpaid dividends.

Due to the redemption features, GAAP required the preferred shares to be recorded as debt. Expenses related to the preferred offering were netted against the liability. The liability was being accreted to its face value using the effective interest rate method and the accretion recorded as interest expense. Dividends due on the preferred shares were also included in interest expense. The net carrying value of the preferred stock, including accrued dividends, was \$45,635,369 at December 31, 2007.

**PHOENIX COAL INC.**

**NOTES TO INTERIM FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

**Three and Six Months Ended June 30, 2008 and 2007**

On June 27, 2008, in conjunction with the reverse takeover, the preferred stock and accrued preferred dividends were converted to common stock at the conversion price of \$1.25 per share. The carrying value of the preferred stock prior to the conversion was reclassified to common equity. A summary of the conversion is as follows:

	<b>Dollars</b>	<b>Common Shares Issued at \$1.25</b>
Preferred stock gross proceeds .....	\$46,487,833	37,190,267
Preferred stock offering costs net of accretion.....	(310,115)	—
Preferred share dividends accrual .....	2,745,004	2,196,003
Amounts reclassified to common stock	<u>\$48,922,722</u>	<u>39,386,270</u>

In November 2007, the Company entered into a loan agreement with a finance company, acting as administrative agent for a syndicate of lenders, for Cdn\$6,000,000. The note was collateralized by, among other things, the assets of PACT, was scheduled to mature on October 31, 2008, and bore interest at 12%. Interest on the note was paid monthly. The principal amount of the loan could be converted, in whole or in part, by the lenders at the time of an initial public offering of securities of the Company, at a conversion price equal to 90% of the offering price. The value of the note was adjusted to U.S. dollars based on current exchange rates, and any adjustments were charged or credited to the consolidated statement of operations. The value of the outstanding loan was \$6,072,240 as of December 31, 2007. As consideration for the loan, the Company paid to the lenders a non-refundable \$600,000 bonus in the form of 480,000 shares of common stock at a deemed price of \$1.25 per share.

In May 2008, the Company modified its loan agreement with the finance company, acting as administrative agent for a syndicate of lenders, that initially loaned the Company Cdn\$6,000,000 in November 2007. The Company borrowed an additional Cdn\$5,000,000 million (the “**Additional Loan**”). The net proceeds of the Additional Loan after fees and converting to U.S. dollars was \$4,877,000. The terms and conditions of the loan agreement were substantially the same except for the conversion price employed should the lenders exercise their right to convert the principal amount of the loan to common equity. The principal amount of the loan (including the initial loan, which was amended at the time of the Additional Loan) was convertible, in whole or in part, by the lenders at the time of an initial public offering of securities of Phoenix or reverse takeover involving Phoenix (a “**Going Public Transaction**”) at a conversion price equal to 80% of the Going Public Transaction offering price. As consideration for the Additional Loan, the Company paid to the lenders a non-refundable \$510,204 bonus in the form of 408,163 shares of common stock at a deemed issue price of \$1.25 per share.

On June 13, 2008, the Company and the finance company, on behalf of each of the lenders, entered into an agreement clarifying the terms of the loan agreement modified in May 2008 pursuant to which, provided that no event of default has occurred and is continuing, (A) immediately prior to completion of the direct share exchange, expected to occur on or before June 30, 2008, the principal amount of the Bridge Loan would be fully converted into common stock of the Company at a conversion price of \$1.25 per share of common stock, such that upon conversion, the finance company (or its designees) would receive a number of shares of common stock equal to Cdn\$11,000,000 divided by \$1.25 (based on the Canadian dollar to United States dollar exchange rate at the time of the conversion), and (B) no adjustment to the number of bonus shares of common stock issued in connection with the Bridge Loan would be required. The agreement was conditional upon, among other things, the offering closing on or prior to July 2, 2008.

As a result of the modifications of the conversion terms of the November 2007 debt, pursuant to EIC-96, Accounting for the Early Extinguishment of Convertible Securities through Early Redemption or Repurchase and Induced Early Conversion, the Company distributed an estimated 499,000 additional shares to the lenders related to the November 2007 debt of Cdn\$6,000,000, since the conversion price decreased from 90% of the offering price to \$1.25. As a result of the additional shares distributed, the Company recorded a charge to accumulated deficit and an offsetting increase to share capital of \$808,258.

On June 23, 2008, the finance company, on behalf of each of the lenders, elected to convert the entire principal amount of the loan into shares of common stock of Phoenix Coal Corporation. Based on a loan value of \$10,835,000, and a conversion price of \$1.25 per share, Phoenix Coal Corporation issued 8,668,000 common shares to the lenders. The loan value of

**PHOENIX COAL INC.**

**NOTES TO INTERIM FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

**Three and Six Months Ended June 30, 2008 and 2007**

\$10,835,000, less unamortized loan costs of \$558,318, was credited to share capital. The assets collateralizing the loan will be released.

Long-term debt consists of the following:

	<b>June 30, 2008</b>	<b>December 31, 2007</b>
	(unaudited)	
Equipment notes payable, interest at 5.25% to 8.41%. Payments are made in monthly installments. The loans are collateralized by related assets with a net book value of \$16,645,179 as of June 30, 2008 and have maturity dates from October 2010 to December 2012.....	\$14,352,536	\$9,687,113
Less: current maturities.....	(3,796,359)	(2,338,198)
	<b>\$10,556,177</b>	<b>\$7,348,915</b>

Expected maturities of notes payable based on years ending December 31 are as follows:

2008 (remaining six months) .....	\$ 1,867,948
2009 .....	3,919,308
2010 .....	3,915,845
2011 .....	3,277,615
2012 .....	1,371,820
	<b>\$14,352,536</b>

In 2006, the Company entered into an interest rate swap transaction whereby the interest payments on an original notional dollar amount of \$7,000,000 are converted to a fixed rate of 8.10% compared to a variable rate of LIBOR re-measured on a quarterly basis. The notional amount decreases over the life of the swap agreement, which expires in December 2011. The notional amounts of the agreement were \$4,900,000 and \$5,483,333 at June 30, 2008 and December 31, 2007, respectively. Under the agreement, the Company pays or receives the net interest amount monthly, with the monthly settlements included in interest expense.

In 2006, management designated the interest rate swap agreement as a cash flow hedging instrument, and determined the agreement met the requirements for hedge accounting under GAAP. For 2006, the agreement was recorded at its fair value with subsequent changes in fair value included in comprehensive income. In August, 2007, the debt to which this swap was related was retired. As a result, the amount previously recorded in other comprehensive income was charged to interest expense and any future changes to the fair value of the swap will either increase or decrease interest expense as the contract no longer qualifies as an accounting hedge.

The fair value of the derivative was \$209,536 and \$224,696 at June 30, 2008 and December 31, 2007, respectively and is included in accrued liabilities on the consolidated balance sheet. On July 15, 2008 the Company paid \$237,200 to terminate the derivative.

**NOTE H — FINANCIAL RISK FACTORS**

The Company's risk exposures and the impact on the Company's financial instruments are summarized below:

*Credit Risk;* Credit risk is the risk of a financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligation.

Financial instruments that potentially subject the company to credit risk are trade receivables from unrelated parties. While economic factors can affect credit risk, the Company manages risk by providing credit terms on a case- by- case basis. Customers are primarily investment grade companies and quasi-governmental agencies. As a result, the Company has not experienced any instances of non-payment.

PHOENIX COAL INC.

NOTES TO INTERIM FINANCIAL STATEMENTS (UNAUDITED) (Continued)

Three and Six Months Ended June 30, 2008 and 2007

*Liquidity Risk:* Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. The Company manages its liquidity by ensuring that there is sufficient capital to meet short and long-term business requirements, after taking into account cash flows from operations and the Company's holdings of cash and cash equivalents. The Company also strives to maintain sufficient financial liquidity at all times in order to participate in investment opportunities as they arise, as well as to withstand sudden adverse changes in economic circumstances. Management forecasts cash flows for its current and subsequent fiscal years to predict future financing requirements. Future requirements are met through a combination of committed credit facilities and access to capital markets. At June 30, 2008, the Company had \$71.2 million of cash and cash equivalents.

*Interest Rate Risk:* Interest rate risk is the risk borne by an interest-bearing asset or liability as a result of fluctuations in interest rates. Financial assets and financial liabilities with variable interest rates expose the Company to cash flow interest rate risk. The Company's most significant interest rate risk arises from its various credit facilities which bear variable interest based on LIBOR. (This facility was retired on July 7, 2008.) There is a cash flow risk associated with the impact of changing interest rates or payments under the credit facilities.

*Currency Risk:* The Company's functional currency is the U.S. dollar and the Company's sales are denominated in U.S. dollars. As the Company operates in an international environment, some of the Company's financial instruments and transactions are denominated in currencies other than the U.S. dollar. The results of the Company's operations are subject to currency transaction risk and currency translation risk.

**NOTE I — COMMITMENTS AND CONTINGENT LIABILITIES**

In the normal course of business, the Company makes various commitments and incurs certain contingent liabilities including liabilities related to reclamation costs and financial obligations in connection with mining permits that are not reflected in the accompanying balance sheet. The Company does not anticipate any material losses as a result of these transactions. In accordance with Kentucky state law, the Company is required to post reclamation bonds to assure that reclamation work is completed. Outstanding reclamation bonds totaled approximately \$8 million at June 30, 2008 and approximately \$9 million at December 31, 2007. These bonds are secured by letters of credit issued by a bank equal to the amount of the outstanding reclamation bonds. The letters of credit are collateralized by general business assets of the Company and the restricted cash on the balance sheet of \$2,226,075 and \$2,312,500 at June 30, 2008 and December 31, 2007, respectively. In July 2008, the Company agreed to increase its restricted cash collateral balance with its bank to 100% of the reclamation bonds outstanding. As a result, the letters of credit are only collateralized by the restricted cash balance, and the general business assets of the Company will be released.

The Company leases certain office space and mining equipment over long-term operating leases running through 2010. Future minimum lease commitments under non-cancelable operating leases as of June 30, 2008, are as follows:

2008 .....	\$532,410
2009 .....	338,160
	<u>\$870,570</u>

A significant amount of the Company's coal reserves are controlled through leasing arrangements and non-cancellable royalty lease agreements under which future minimum lease payments are due.

As of, and subsequent to, June 30, 2008, the Company has committed to purchase approximately \$16,500,000 of mining equipment for its operations, with delivery scheduled during the second half of 2008. The Company expects to execute notes with equipment financing companies to finance the purchase of the equipment, and is currently negotiating the terms of the notes. The notes will be collateralized by the equipment purchased.

## PHOENIX COAL INC.

### NOTES TO INTERIM FINANCIAL STATEMENTS (UNAUDITED) (Continued)

Three and Six Months Ended June 30, 2008 and 2007

#### NOTE J — STOCK INCENTIVE PLAN AND WARRANTS

##### 2007 Stock Option Plan of MCC

MCC adopted an incentive stock option plan in May 2007 (the “**2007 Plan**”) which provides that the Board of Directors of the Company may from time to time, in its discretion, and in accordance with TSX requirements, grant to directors, officers, employees and technical consultants to the Company, non-transferable options to purchase common shares, provided that the number of common shares reserved for issuance will not exceed 10% of the issued and outstanding common shares. Such options will be exercisable for a period of up to 5 years from the date of grant. Vesting terms will be determined at the time of grant by the Board of Directors.

In 2007, upon closing of an initial public offering, the Company granted to its directors and officers options to acquire 150,000 Shares at a price of Cdn\$0.25 per share, exercisable for a period of five years from August 28, 2007.

The 2007 Plan remains in force and options issued prior to the Merger will continue to be governed by the 2007 Plan; however due to the approval of the 2008 Plan (defined below), no further options will be issued pursuant to the 2007 Plan.

##### 2004 Stock Incentive Plan of Phoenix

Phoenix’s 2004 stock incentive plan (the “**2004 Plan**”) authorizes Phoenix’s board of directors to grant options to its employees (including officers), directors and consultants. Pursuant to the 2004 Plan, Phoenix can issue “non-statutory options” and “incentive stock options” to purchase shares of Common Stock of Phoenix as well as “stock purchase rights”. The number of shares of common stock or rights of Phoenix authorized and reserved for issuance under the 2004 Plan was fixed at 8,297,411.

Stock options are generally subject to vesting provisions of 25% at the end-of-year one from the date of grant and then evenly over the following 48 months. The options are granted at a price equal to 100% of the fair value of the Company’s common stock on the date of grant and have a ten-year term.

Pursuant to the Merger Agreement, each Phoenix stock option was cancelled and extinguished and the holder received a replacement option of the Company to purchase that number of Common Shares equal to the number of Phoenix Common Stock issuable under the Phoenix option with no change in the exercise price of such options due to the nature of the exchange rate between United States dollars and Canadian dollars.

##### 2008 Stock Option Plan of the Company

In connection with completion of the RTO, MCC adopted a new stock option plan (the “**2008 Plan**”) on May 20, 2008, to become effective, subject to receipt of shareholder approval and all requisite regulatory approvals, upon the closing of the RTO.

The 2008 Plan is designed to advance the interests of the Company by encouraging employees, officers, directors and consultants to have equity participation in the Company through the acquisition of Common Shares. The current intention is to use the 2008 Plan for option grants to employees, officers, directors and consultants of the Company. Options granted under the 2008 Plan may be Incentive Stock Options or Non-Qualified Stock Options. The 2008 Plan was approved in June 2008 and 13,500,000 Common Shares are reserved for issuance under the 2008 Plan.

The exercise price per Common Share is not to be less than market price of the Common Shares at the time of the grant). The exercise period for each stock option is not to be more than ten years (five years in the case of an Incentive Stock Option granted to a person who owns more than 10% of the issued and outstanding Common Shares). Options may be granted subject to vesting requirements.

Unless terminated earlier by the Board of Directors, the 2008 Plan will remain in effect until all options granted under the 2008 Plan have been exercised or forfeited, or have expired. However, no new options may be granted under the 2008 Plan more than 10 years from the date the Plan was originally adopted by the Board of Directors.

**PHOENIX COAL INC.**

**NOTES TO INTERIM FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

**Three and Six Months Ended June 30, 2008 and 2007**

Information regarding stock option activity under the Plans follows:

<b>2004 Phoenix Plan Common Share Options</b>	<b>Number of Options</b>	<b>Weighted Average Exercise Price</b>
Balance, December 31, 2007.....	6,749,000	\$0.87
Granted.....	1,000	1.25
Forfeited.....	<u>(164,500)</u>	1.25
Balance on June 27, 2008, pre RTO.....	6,585,500	0.86
Forfeited.....	<u>(37,500)</u>	1.25
Options outstanding at June 30, 2008.....	<u>6,548,000</u>	<u>\$0.85</u>
Options exercisable at June 30, 2008.....	<u>3,139,658</u>	<u>\$0.68</u>
<b>Options Denominated in Canadian Dollars 2007 MCC Plan and 2008 Company Plan</b>	<b>Number of Options</b>	<b>Weighted Average Exercise Price</b>
Balance, December 31, 2007.....	150,000	Cdn\$0.25
Consolidated at 1:2.35.....	<u>(86,170)</u>	
Balance after consolidation.....	63,830	Cdn 0.59
Granted under 2008 Plan.....	<u>6,847,000</u>	Cdn 1.75
Options outstanding at June 30, 2008.....	<u>6,910,830</u>	<u>Cdn\$1.74</u>
Options exercisable at June 30, 2008.....	<u>2,323,340</u>	<u>Cdn\$1.72</u>

Compensation cost of stock option grants is recognized straight-line over the options' vesting periods. Compensation expense related to stock options for the six months ended June 30, 2008 and 2007 were \$2,291,277 and \$-0-, respectively. (In 2007, \$948,859 of stock option expense was recorded in the fourth quarter.) The options' fair value was determined using the Black-Scholes option-pricing model. Expected volatilities are based on comparable company historical stock movement, and other factors. The cost relating to the stock-based compensation plans is included in general and administrative expenses in the accompanying consolidated statements of operations.

	<u>2008 Company</u>	<u>2007 Phoenix</u>	<u>2007 MCC</u>
Weighted average fair value per share of options granted.....	\$.89 per share	\$.73 per share	\$.21 per share
Assumptions (weighted average):			
Risk-free interest rate.....	3.99%	4.37%	4.75%
Expected dividend yield.....	0.00	0.00	0.00
Expected volatility.....	0.40	0.40	1.25
Expected option life (in years).....	10.00	10.00	5.00

At June 30, 2008 the following stock options were outstanding:

<u>Number of Options</u>	<u>Exercise Price</u>	<u>Expiration Date</u>
1,245,000	\$0.25	April, 2015
905,000	\$0.25	December, 2015
595,000	\$0.50	May, 2016
920,000	\$1.25	March, 2017
2,883,000	\$1.25	November, 2017
63,830	Cdn\$0.59	August, 2012
<u>6,847,000</u>	Cdn\$1.75	June, 2018
<u>13,458,830</u>		

**PHOENIX COAL INC.**

**NOTES TO INTERIM FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

**Three and Six Months Ended June 30, 2008 and 2007**

**Phoenix Warrants**

As part of the fee structure related to Phoenix's preferred stock offering in August 2007, the underwriter received warrants to purchase 1,780,000 shares of the preferred stock of the Company at \$1.25 per share. The warrants expire 24 months following the date the Company consummates an initial public offering of shares of common stock of the Company. The warrants total value of \$462,800 was determined using the Black-Scholes option pricing model. Assumptions used in the model were a risk free interest rate of 4.76%, dividend yield of 6.50%, and expected volatility of .40. The value of the warrants was charged to additional paid in capital. On June 27, 2008, under the terms of the Broker Agreement, the warrants were converted to warrants to purchase common shares of the Company at \$1.25 per common share. The warrants expire June 25, 2010.

**Company Warrants**

Under the terms of the Offering, 31,428,580 warrants were issued to the purchasers of the common shares offered. The warrants entitle the holder to purchase one common share for each warrant held at a price of Cdn\$2.25 per share. The warrants expire June 25, 2010. The warrants total value of \$8,077,145 was determined by the underwriter of the Offering. The value of the warrants was charged to share capital.

Information regarding the warrant activity follows:

	<u>Number of Warrants</u>	<u>Weighted Average Exercise Price</u>
<b>Phoenix Preferred Share Warrants</b>		
Balance, December 31, 2007.....	1,780,000	\$1.25
Converted preferred warrants to common warrants.....	(1,780,000)	1.25
Balance, June 27, 2008.....	<u>-</u>	<u>\$ -</u>

	<u>Number of Warrants</u>	<u>Weighted Average Exercise Price</u>
<b>Phoenix Common Share Warrants</b>		
Balance, December 31, 2007.....	-	\$ -
Converted preferred warrants to common warrants.....	1,780,000	1.25
Balance on June 27, 2008, pre RTO and balance at June 30, 2008.....	<u>1,780,000</u>	<u>\$1.25</u>
Warrants exercisable at June 30, 2008.....	<u>1,780,000</u>	<u>\$1.25</u>

	<u>Number of Warrants</u>	<u>Weighted Average Exercise Price</u>
<b>Warrants Denominated in Canadian Dollars</b>		
<b>Company Common Share Warrants</b>		
Balance, December 31, 2007.....	100,000	Cdn\$0.25
Consolidated at 1:2.35.....	(57,447)	
Balance after consolidation.....	42,553	Cdn 0.59
Warrants issued with new shares.....	31,428,580	Cdn 2.25
Warrants outstanding at June 30, 2008.....	<u>31,471,133</u>	<u>Cdn\$2.25</u>
Warrants exercisable at June 30, 2008.....	<u>31,471,133</u>	<u>Cdn\$2.25</u>

**PHOENIX COAL INC.**

**NOTES TO INTERIM FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

**Three and Six Months Ended June 30, 2008 and 2007**

At June 30, 2008 the following warrants were outstanding:

<u>Number of Warrants</u>	<u>Exercise Price</u>	<u>Expiration Date</u>
1,780,000	\$1.25	June, 2010
42,553	Cdn\$0.59	August, 2012
<u>31,428,580</u>	Cdn\$2.25	June, 2010
<u>33,251,133</u>		

**Broker Options**

Under the terms of the Offering, the agents received Brokers' Options entitling the agents to purchase in the aggregate 2,514,286 Brokers' Units. Each unit entitles the agent to purchase one common share for Cdn\$1.75 per share and one half warrant entitling the agent to purchase one common share for each full warrant at Cdn\$2.25 per share. The Brokers Options expire June 25, 2010 and are all exercisable at June 30, 2008. The options total value of \$1,106,286 was determined using the Black-Scholes option pricing model. Assumptions used in the model were a risk free interest rate of 3.99%, no dividend yield, and expected volatility of .40. The value of the options was charged to share capital as a cost of the Offering.

**NOTE K — RELATED PARTY TRANSACTIONS**

The Company enters into transactions with stockholders and/or affiliated entities that have some level of common ownership with the Company. A summary of the related party transactions and balances follows for the six months ended June 30, 2008 and 2007:

	<u>Six Months Ended</u>	
	<u>2008</u>	<u>2007</u>
Expenses:		
Consulting fees .....	\$156,000	\$330,000
Rent and miscellaneous .....	32,925	39,243
Accounts receivable.....	16,858	13,077
Accounts payable.....	3,741	5,134

These transactions were paid to MHI Energy Partners, LLC, which amounts were applied towards, among other things, salaries, overhead and benefits for individuals who provided services. These transactions are also in the normal course of business, and are recorded at the consideration established and agreed to by the related parties.. David Wiley and Timothy Fogarty were managing directors of MHI Energy Partners, LLC. David Wiley is currently a director of the Company and Phoenix, and Tim Fogarty is currently a director of Phoenix. During the second quarter of 2008, the Company discontinued these payments to MHI.

**NOTE L — SUBSEQUENT EVENTS**

In July 2008, the Company's subsidiary, R&L Winn Inc. ("R&L Winn"), purchased all of the outstanding common shares of C&R Coal Inc ("C&R"). Under the terms of the agreement, R&L Winn assumed all assets and liabilities of C&R and will pay the former owners \$.60 per ton for each ton of coal sold from the C&R mines. The current mining area, Beech Creek and Beech Creek South, contained approximately 500,000 reserve tons (697,000 reserves tons as of December 31, 2007 per the Company's National Instrument 43-101 revised technical report less coal mined in the first half of 2008) as of June 30, 2008. R&L Winn also acquired other leases in the transaction from C&R and R&G Leasing, LLC, a company that is affiliated with C&R through common ownership. Based on exploration completed to date by the Company, management estimates the leases contain approximately five to seven million tons of coal. The potential quantity is conceptual in nature as there has been insufficient exploration to define a mineral resource and it is uncertain that further exploration will result in

**PHOENIX COAL INC.**

**NOTES TO INTERIM FINANCIAL STATEMENTS (UNAUDITED) (Continued)**

**Three and Six Months Ended June 30, 2008 and 2007**

the delineation of a mineral resource. The Company has engaged a third party engineering firm to issue a technical report that is compliant with National Instrument 43-101.

In July 2008, Phoenix purchased all of the outstanding common shares of Renfro Equipment, Inc. (“Renfro”) for a purchase price of \$1,500,000. The purchase includes all assets and liabilities of Renfro, except certain equipment and associated debt specifically excluded from the purchase. The purchase price will be adjusted for net working capital as of the closing date. Based on exploration completed to date by the Company, management estimates Renfro controls approximately 1.5 million tons of coal via lease. The potential quantity is conceptual in nature as there has been insufficient exploration to define a mineral resource and it is uncertain that further exploration will result in the delineation of a mineral resource. The Company has engaged a third party engineering firm to issue a technical report that is compliant with National Instrument 43-101. Additionally, if by the second anniversary of the closing date, Phoenix acquires at least 1.5 million reserve tons as defined by National Instrument 43-101 due to the direct efforts of the sellers (the “Additional Reserves”), the Company will pay the sellers \$1,000,000 for the first 1.5 million tons of reserves, plus \$0.50 per ton for each reserve ton in excess of 1.5 million. The share purchase agreement defines a specific territory from which the Additional Reserves can be acquired. The acquisition of the Additional Reserves is on terms and conditions acceptable to Phoenix in its sole, reasonable discretion.